

TAX·FEATURES

TF Shadow Budget Committee Cautions Against "Euphoric" Budget Outlook

\$6,867 Federal Tax Bill For \$28K Moderate Earner

The Federal government is spending an estimated \$979.9 billion in fiscal year 1986. A moderate-income family—one worker earning \$28,000 solely from wages with a spouse and two dependent children—faces a tax bill of \$6,867 for fiscal year 1986, according to Tax Foundation economists.

"Income security" costs the most. This comprises social security and Federal employee retirement and disability, unemployment insurance, housing assistance, food and nutrition assistance, and other programs. The total outlay by Uncle Sam will be \$318.1 billion. It will cost the \$28,000 earner \$2,150. In other words, the Federal government will pay out 31 cents for "income security" programs for each \$1 this taxpayer sends to Washington.

National defense will cost \$265.8 billion—or 26 cents out of each tax dollar. For the moderate-income taxpayer described here, this amounts to \$1,797.

Interest on the public debt ranks third—\$142.7 billion; for this worker, the tab will be \$965, over 14 cents per dollar of taxes.

Health outlays, estimated to total more than \$104.3 billion, will cost the moderate-income family \$705, or 10 cents for each tax dollar paid.

That's more than 80 percent of all Federal spending for the four largest programs. Other functional programs that will cost the moderate-income taxpayer over \$100 in 1986 are: education, training, employment, and social services (\$207); transportation (\$183); veterans' benefits and services (\$180); agriculture (\$175); and international affairs (\$116). The table on page 4 gives more details.

Another category of major Federal spending that cuts across functional lines as classified in the budget, will preempt nearly half the budget dollar. This is "payments for individuals." In 1986 these payments will add up to \$445.9 billion, a cost of \$3,124 for the moderate income family, or 46 cents of every tax dollar. This covers the income security items shown above; payments for veterans; assistance to students; health and medical care under medicare and medicaid and other programs; and other payments to individuals under special programs.

Taxes, nontaxes, and borrowing support government programs. The individual income tax provides

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Tax Foundation's Shadow Committee on the Federal Budget called for caution in embracing the recent wave of euphoria over the Federal budget outlook. "This euphoria is based more on changed assumptions than on actual changes in the budgetary policies of the Federal government," the Committee said in a report released March 3.

The strengthening economy, the Committee said, made "achievement of the fiscal 1987 revenue target . . . probable though by no means assured." Committee members found less cause for optimism on the expenditure side of the fiscal 1987 budget, calling the plan "far less plausible than the revenue projection."

The Shadow Committee on the Federal Budget is a citizens' watchdog group operating under the auspices of the Tax Foundation. The Committee monitors Federal budgetary action in a manner similar to the way the Shadow Open Market Committee monitors the actions taken by the Federal Reserve Board with respect to monetary policy.

Leif H. Olsen, former chairman, Economic Policy Committee of Citibank, N.A., chairs the Shadow Committee on the Federal Budget. Other members are The Honorable Harry F. Byrd, Jr., W. Bowman Cutter, Allen Schick, and The Honorable Al Ullman.

The Committee report noted, "The achievement of the fiscal 1988 and later deficit reduction targets will depend on a clock-work falling into place of optimistic economic assumptions and expenditure restraint unprecedented for more than 50 years." Warning of possible efforts to step up spending in the wake of the recovery, the Committee said, "The method used in constructing the baseline assumes that, as revenues grow, Congress and the Administration will not take actions that add to Federal spending. But with a long time span and a buoyant economic forecast, the baseline tends to lull policymakers into believing that they can expand programs without risking higher future deficits." The Committee cautioned against "this type of wishful thinking" pointing out that such an attitude "gave rise to the contemporary deficit crisis, and it is urgent that we not repeat the mistake again."

The report called for "persistent real efforts at fiscal restraint" if the government is "to meet the fiscal 1987 deficit target and approximate the targets for later years."

Leif H. Olsen, who chairs the Shadow Committee on the Federal Budget, served as Chairman, Economic Policy Committee of Citibank, N.A., from 1977-1985.

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General Sales Biggest Tax Source for States

Sales taxes still bring in the most money for the states, according to recent analysis by the Tax Foundation,

Incorporated. Economists at the Washington-based tax watchdog organization say that general sales taxes, which are levied by 45 states, brought in \$62.6

billion to state treasuries in fiscal year 1984—nearly one-third (31.8 percent) of all state tax collections that year.

Second as a major revenue raiser was the personal income tax, bringing in \$58.9 billion in fiscal 1984 for 30.0 percent of total tax receipts. Corporate income taxes, the third largest single tax source, amounted to \$15.5 billion, 7.9 percent of the total. Only five states (Nevada, South Dakota, Texas, Washington, and Wyoming) have neither a corporate nor a personal income tax, and only seven states (the previous five plus Alaska and Florida) have no individual income tax.

Each of the 50 states taxes gasoline, which brought in \$12.4 billion (6.3%) of their total taxes in fiscal 1984.

All states have local property taxes, and 41 have state property taxes; 39 states have both general sales and income taxes; and 33 states have general sales, income, and property taxes, Tax Foundation economists say.

State Sales Taxes

Connecticut led the list for top rates with its 7.5 percent sales and use tax rate, followed by: Washington (6.5 percent); Minnesota, Mississippi, New Jersey, Pennsylvania, and Rhode Island (6 percent); and Nevada (5.75 percent). No state general sales tax is levied in Alaska, Delaware, Montana, New Hampshire, or Oregon, although municipalities in Alaska do impose sales tax.

The state sales tax is lowest—3 percent—in six states: Colorado, Georgia, Kansas, North Carolina, Virginia, and Wyoming. Localities in 26 states levy sales taxes, generally in addition to those shown in the accompanying table.

(Continued on page 4)

Major Taxes and Rates Used by States As of January 1, 1986

State	Income taxes		General sales and use tax	Gasoline tax (per gallon)	Cigarette tax (per pack of 20)	Property tax
	Corporation	Individual				
Alabama	5% (F)	2 to 5% (F)	4% ^a	11¢	16.5¢	X
Arizona	2.5 to 10.5 (F)	2 to 6 (F)	5 ^a	16	15	X
Arkansas	1 to 6	1 to 7	4 ^a	13.5	21	X
California	9.6	1 to 11	4.75 ^a	9	10	X
Colorado	5 ^b	3 to 8 (F)	3 ^a	12	15	X
Connecticut	11.5 ^c	1 to 13 ^d	7.5	15 ^e	26	X
Georgia	6	1 to 6	3 ^a	7.5 + 3% of retail	12	X
Hawaii	5.85 to 6.435	2.25 to 11	4	15 to 18.5	40% wholesale	
Idaho	7.7	2 to 7.5	4	14.5	9.1	X
Illinois	4	2.5	5 ^a	12	20	X
Indiana	3 ^f	3	5	14.1	10.5	X
Iowa	6 to 12 (F)	.5 to 13 (F)	4	15	26	X
Kansas	4.5 ^g	2 to 9 (F ^h)	3 ^a	11	24	X
Kentucky	3 to 7.25	2 to 6 (F ^h)	5	10 ⁱ	3.001	X
Louisiana	4 to 8 (F)	2 to 6 (F)	4 ^a	16	16	X
Maine	3.5 to 8.93	1 to 10	5	14	28	X
Maryland	7	2 to 5	5	13 ⁱ	13	X
Massachusetts	8.33 ^j	5 ^b	5	11	26	X
Michigan	2.35	5.1 ^b	4	15	21	X
Minnesota	6 to 12	1.5 to 14 (F)	6 ^a	17	23	X
Mississippi	3 to 5	3 to 5	6	9	18	X
Missouri	5 (F)	1.5 to 6 (F)	4.225 ^a	7	13 ⁱ	X
Nebraska	4.75 to 6.65	19% of Federal income tax	3.5 ^{a,e}	17.2	18 ⁱ	X
New Jersey	9 ⁱ	2 to 3.5	6	8	25	X
New Mexico	4.8 to 7.2	.7 to 7.8 ^m	3.75 ^a	11	12	X
New York	10 ⁱ	2 to 13.5 ^b	4 ^a	8	21	X
North Carolina	6	3 to 7	3 ^a	12	2	X
North Dakota	3 to 10.5 (F)	2 to 9 ⁿ (F)	4	13	18	X
Ohio	5.1 to 9.2 ^c	.85 to 8.55 ^b	5 ^a	12	14	X
Oklahoma	5	.5 to 6 ^m (F)	3.25 ^a	10	18	X
Pennsylvania	9.5	2.2	6	12	23.4	X
Rhode Island	8 ⁱ	22.21% of Federal income tax	6	13 ⁱ	23	X
South Carolina	6	2 to 7 (F)	5	13	7	X
Tennessee	6	6 ^d	5.5 ^a	12	13	X
Utah	5	2.25 to 7.75 (F)	4.625 ^{a,b}	14	12	X
Vermont	6 to 9 ^b	26.5% of Federal income tax	4 ^b	13	17	X
Virginia	6	2 to 5.75	3 ^a	11	2.5	X
West Virginia	6 to 7 ^e	2.1 to 13	5	10.5	17	X
Wisconsin	7.9	5 to 7.9	5	16	25	X
Florida	5.5		5 ^a	4	21	X
Nevada			5.75 ^a	11.25	15	X
South Dakota			4 ^a	13	23	
Texas			4.125 ^a	10	20.5	
Washington			6.5 ^a	18	23	X
Wyoming			3 ^a	8	8	X
Alaska	1 to 9.4			8	16	X
Delaware	8.7	1.2 to 9.7 (F)	5 states have no general sales tax	11	14	X
Montana	6.75 ^m	2 to 11 (F)		15	16	X
New Hampshire	8.25	5 ^d		14	17	X
Oregon	7.5	4 to 10 (F)		11	27	X

(X) Indicates state levies a property tax.

(F) Allows Federal income tax as a deduction.

^a Local taxes are additional.

^b Future reduction scheduled under current law.

^c Alternative methods of calculation may be required.

^d In Connecticut, New Hampshire, and Tennessee, tax applies to income from intangibles only, at various rates according to type.

^e Future increases scheduled under current law.

^f Tax is 3% of adjusted gross income. A supplemental net income tax is imposed at 4%.

^g A 2-1/4% surtax is imposed on taxable income in excess of \$25,000.

^h Deductions limited.

ⁱ Tax imposed at percent of wholesale value.

^j Additional 14% surtax is imposed.

^k Tax of 10% on income derived from intangibles, and 5% on all other income, and an additional 3.75% tax for 1986.

^l Additional tax on net worth is part of the corporate franchise tax.

^m Qualified taxpayers may elect to pay alternative taxes at varying rates.

ⁿ Optional tax of 10.5% of taxpayer's adjusted Federal income tax liability.

Source: Compiled by Tax Foundation from data reported by Commerce Clearing House.

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State Tax and Fiscal Prospects, 1986

By Elsie M. Watters
Vice President-Research
Tax Foundation, Incorporated

Tax issues will be confronted by more than half of the state legislatures holding regular sessions in 1986. Pending legislation, however, stands to have little overall effect on the level of state taxes, because increases contemplated in some states are likely to be offset by reductions elsewhere. Moreover, the states with the most pressing fiscal problems appear generally to be looking more to spending cuts than tax increases to ease budget pressures.

As of early March, a Tax Foundation survey found that 16 states were considering increases in one or more major taxes (sales, income, excises). At the same time, tax reductions were the major issue in at least 6 states, generally those where sizable budget surpluses are projected. In at least 14 states, potential budget deficits in fiscal 1986 were headed off by spending cuts; and in many states, proposed spending increases for fiscal 1987 are either modest or nonexistent.

While the large majority of states are not seeking new revenues in 1986, the finances of most states mirror, to a varying degree, the influence of several forces tending to exert downward pressures on revenues.

(1) Most important among them has been the slowing in the momentum of overall economic growth since 1984, which lowered automatic tax increases below earlier projections and led to "revenue shortfalls." Gross national product (GNP) growth in current dollars slowed from 11.0 percent in 1984 to 5.7 percent in 1985. State tax revenues, which jumped nearly 15 percent in fiscal 1984, rose by less than 9 percent in 1985.

(2) In several states, notably those heavily dependent upon energy resources and agriculture, economic performance fell well below the national average, upsetting financial plans made earlier under more favorable assumptions.

(3) Some substantial tax increases enacted to bolster state receipts during and after the 1981-82 recession have expired or been repealed, and new tax cuts have slowed revenue growth in some states.

(4) In the past five years, Federal grants-in-aid have dropped from 26 percent of state-local general expenditures to 21 percent, and further reductions are expected.

On the spending side also there have been forces at work tending to put pressures on available revenues. Recent state commitments, for example, to "excellence in education" mean that the states are picking up from local governments a larger share of the expanded tab for local schools and other

programs in education. Improved road and highway systems are also on the priority list in several states, along with expanded programs for water projects, pollution control, prison reforms, and a host of other purposes.

The states considering tax increases in 1986 include: Alabama, Colorado, Florida, Hawaii, Idaho, Kansas, Louisiana, Missouri, Nebraska, New Mexico, North Carolina, South Dakota, Tennessee, Virginia, Washington, and West Virginia. Aggregate increases, if all proposals were approved, could yield about \$1.5 billion in new annual revenues. Slightly over half of that (\$850 million) would represent higher sales taxes in 7 states. The remainder (\$650 million) would be in the form of higher cigarette levies (3 states) and motor fuels taxes (8 states).

Besides these major tax proposals, some states appear to be examining all possible sources of new revenues. The approaches include: cutting down on general sales tax exemptions; eliminating the once-popular subsidies for ethanol (gasohol) sales; imposing taxes on smokeless tobacco where it is not now taxed; amnesty programs to recover unpaid taxes; new forms of legalized gambling—lotteries, casinos, and parimutuels; and giving local governments a freer rein in raising taxes for themselves.

On the other hand, either the governors or legislative leaders (or both) are calling for tax reductions in Connecticut, Delaware, Michigan (a \$360 million income tax reduction has already been enacted this year), New York, Pennsylvania, and Rhode Island. The reductions, largely in income or sales taxes, total around \$1.5 billion, about the same size as the proposed hikes in other states.

While not aimed at revenue reduction, legislative consideration of changes in methods of taxing the income of multinational corporations could, if enacted, lead to between \$300-and-\$400 million in additional tax reductions. California, Idaho, New Hampshire, and Utah are considering limiting the scope of these taxes to a "water's-edge" basis.

No regular legislative sessions are scheduled in 1986 in Arkansas, Montana, Nevada, Oregon, and Texas.

Selected State Reports

Alabama. The governor has proposed a tax increase plan to buffer the effects of Federal cutbacks on aid to the poor; he

would raise taxes on cigarettes, beer, and other items for new revenues of \$51.8 million annually. To provide more funds for highway construction, he also proposed eliminating the 3-cents-a-gallon excise tax reduction for gasohol.

Alaska. Falling oil prices will force legislators to look at "all facets" of state taxation of oil-related industries, since about nine-tenths of state revenues are derived from such sources. Although a balanced budget is expected for the "foreseeable future," the price of oil is an important factor. The legislature may also ask the voters to express their views on whether the state should reimpose a personal income tax (the previous tax was repealed in 1979).

Arizona. The governor recommended a \$15 million income tax credit for child and dependent care expenses for working couples. Several proposals would give counties new funding, including authorizing voters to override property tax limits. Voters will be asked to increase the constitutional limit on total spending for schools.

California. The legislature is considering proposals to repeal the state's worldwide unitary approach to corporate income taxation, in favor of a "water's-edge basis," which means that multinational corporations would be taxed only on their income produced in the United States. A similar move was defeated in 1985, and chances of approval this year are regarded as slim. Legislators are also discussing possible revisions in the structure of the personal income tax that would broaden the base and lower rates. The governor's proposed spending budget is in dispute because legislative officials claim that it overstates the amount the state can spend under the Gann constitutional limit set by voter initiative in 1979. The measure requires that revenues above the limit must be returned to taxpayers.

Colorado. The governor recommended increasing the cigarette tax by 8 cents a pack, capping the investment tax credit at \$1,000, and raising motor fuels taxes. Legislative leaders are also considering asking for a hike from 3 percent to 4 percent in the state sales tax.

Connecticut. For the third straight year the state faces a budget surplus. The governor proposes to use it to increase spending by about 11 percent, including a \$100 million increase in aid to education. Senate leaders want additional tax cuts of about \$100 million (in 1985 taxes were cut by \$155 million a year), to which the governor is opposed.

Delaware. The governor recommended tax relief for the business community and for individual taxpayers, totaling \$10.5 million over the second half of fiscal 1987. He would cut public utility and gross receipts taxes and lower personal income taxes by 4 percent across the board (if approved, this would be the third straight year for an income tax cut).

Florida. A newly enacted state comprehensive plan calls for funding many additional services and infrastructure "wants and needs." With an eye to increasing revenues, the legislature is expected to review the coverage of the sales tax and to consider eliminating various exemptions, many of which are scheduled to sunset in 1987. Lawmakers may also

raise cigarette taxes and authorize local governments to levy new taxes, such as a gross receipts tax on business.

Georgia. Stating that the educational reform program enacted in the last session "is being hailed across the country as the most all-inclusive effort yet undertaken by any state," the governor proposed that over 64 percent of all new, non-earmarked funds in the budget be used for education, thus accelerating increases in school spending.

Hawaii. The governor proposed a tax package to increase the general sales tax rate, partly offset by increases in personal exemptions under the income tax. It is estimated that the plan would raise an additional \$20 million a year, to be earmarked for visitor promotion. The legislature offered a counterproposal that would raise the money by increasing the tax on hotels and rentals.

Idaho. The governor recommended broadening the sales tax base to include certain services, "major modifications" in the unitary tax law (adopting a water's-edge method of reporting corporate income for tax purposes), and liberalizing local government authority to levy local option sales and income taxes. Other proposals before the legislature include increased personal income and sales taxes.

Illinois. The legislature may try again to double-weight the sales factor in the corporate income allocation formula. (Currently sales, property, and payrolls receive equal weight in determining the amount of taxable income assignable to each state in which a company does business.) Both houses passed such a bill last year, but the governor vetoed it.

Indiana. The legislature failed to approve bills that would have continued the sales tax exemption for gasohol and prevented state taxation of an Indiana-based corporation's overseas income.

Iowa. Saying that the state "has the worst agricultural crisis since the great depression," the governor called upon the legislature to "streamline government and avoid tax increases." His proposed fiscal 1987 budget would hold spending at the same level as in 1986. Under study in the legislature are proposals to change the structure of the state income tax by limiting the deductibility of Federal taxes.

Kansas. The governor recommended an increase in the sales tax from 3 percent to 4 percent to raise an estimated \$190 million in new revenue for 1987, along with liberalization of the food sales tax refund program for lower income persons. New revenues are said to be needed to restore the state general fund balance, for economic development efforts, highway improvements, education, and to assist counties with financing property reappraisal.

Kentucky. The governor's budget message noted that the economy of the state is growing steadily, with revenue matching or exceeding estimates, and that the budget outlook is far better than in the past eight years.

Louisiana. The state confronts a revenue shortfall of \$150 million in fiscal 1986, due in part to falling oil prices. The governor estimates that about \$800 million more will be needed in 1987 to finance (and expand) current programs and

National Taxpayers Conference on Federal Fiscal Affairs

May 5 & 6, 1986

Loew's L'Enfant Plaza Hotel, Washington, D.C.

Monday, May 5th

11:00 a.m.-12:00 Noon

Registration

12:00 Noon-2:00 p.m.

Luncheon

Chairman: Robert C. Brown, President, Tax Foundation, Incorporated

Speaker: The Honorable Ernest F. Hollings, U.S. Senator from South Carolina
Second Ranking Minority Member, Senate Budget Committee

2:00-5:00 p.m.

Afternoon Session

"The Federal Budget with or without Gramm-Rudman-Hollings"

Chairman: Douglas P. Bates, Special Assistant to the President, Tax Foundation, Incorporated

Speakers: Leif H. Olsen, Chairman, Tax Foundation Shadow Committee on the Budget
Former Senior Vice President and Chief Economist, Citibank, N.A.

Peter Davis, Vice President, Prudential-Bache Securities
Former Tax Economist, Senate Budget Committee

"Interstate Taxation: Is Federal Legislation Coming?"

Chairman: Melvin Morris, Executive Director, Arizona Tax Research Association
Chairman, National Taxpayers Conference

Speakers: Administration View
George N. Carlson, Director, Office of Tax Analysis
U.S. Treasury Department

Business View
William R. Brown, President, Council of State Chambers of Commerce

State View
Basil Wisner, Chief Deputy Controller, State of Maryland
1986 President, National Association of Tax Administrators

6:00-9:30 p.m.

Reception and Dinner

Feature: An Evening with the *Capitol Steps*
(A musical review of Washington politics, especially budget foibles)
(Continued on following page)

Reservation Form—National Taxpayers Conference on Federal Fiscal Affairs

May 5 & 6, 1986 ■ L'Enfant Plaza Hotel ■ Washington, D.C.

Return to: Tax Foundation, Incorporated/One Thomas Circle, N.W./Suite 500/Washington, D.C. 20005 (202) 822-9050.
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National Taxpayers Conference Program (continued)

Tuesday, May 6th

8:30-9:30 a.m.

Breakfast

"The Administration Tax Program"

Chairman: Edward A. Sprague, Senior Vice President-Program Planning and Tax Policy
Tax Foundation, Incorporated

Speaker: The Honorable J. Roger Mentz, Assistant Secretary for Tax Policy
U.S. Treasury Department

9:30 a.m.-12:00 Noon

Morning Session

Chairman: Edward A. Sprague, Senior Vice President-Program Planning and Tax Policy
Tax Foundation, Incorporated

"Senate Consideration of Tax Reform"

Speaker: William Diefenderfer, Chief of Staff, Senate Finance Committee (Invited)

"Business Tax Provisions and Alternatives"

Speakers: Byrle M. Abbin, Managing Director, Office of Federal Tax Services
Arthur Andersen & Co.

Emil R. Sunley, Director of Tax Analysis, Deloitte, Haskins & Sells

"Tax Amnesty Programs"

Speaker: Ira A. Jackson, Massachusetts Revenue Commissioner,
Commonwealth of Massachusetts

12:00 Noon-2:00 p.m.

Luncheon

Chairman: Jared E. Hazleton, President, Texas Research League

Speaker: The Honorable William V. Roth, Jr., U.S. Senator from Delaware
Third Ranking Majority Member, Senate Finance Committee

* * * * *

to provide pay increases for teachers and state employees. The governor's proposals to introduce three forms of legalized gambling—lotteries, casino and cruise ship gambling—to bail the state out of its financial problems met with considerable opposition. Although some legislators are proposing tax increases (e.g., a state property tax) to finance education reforms previously enacted, further tax increases are regarded as unlikely. This is due largely to adverse public reaction to increases enacted two years ago, when the legislature enacted a 25 percent hike in state taxes.

Maine. The governor is proposing a plan to eliminate some tax "loopholes" that would result in changes in sales, insurance, inheritance, and nonresident personal income taxes. A proposal before the legislature would phase out the 5 percent sales tax on energy purchased for use in manufacturing production processes.

Maryland. No significant tax changes are expected in 1986. Bills before the legislature would impose a tax on smokeless tobacco and authorize local sales taxes.

Massachusetts. The major tax issue will be an initiative petition for a state tax limit, holding growth in taxes to the average increase in the state's wage and salary income for the three preceding calendar years. Despite tax reductions last year, prospects for future budget years are said to be favorable. Pressure is expected to come from local governments as Federal cutbacks occur.

Michigan. The personal income tax rate of 5.1 percent was scheduled to drop back to its pre-1983 rate of 4.6 percent on October 1, 1987. Legislation has been approved to accelerate the scheduled drop (which will save taxpayers \$360 million a year) to March 31, 1986. Fiscal 1987 is regarded as "a tight budget year," and the governor's budget calls for \$11 million less than in 1986.

Minnesota. Following tax cuts totaling over \$400 million a year approved by the 1985 legislature, the state faced a shortfall of \$736 million for the current biennium. To avoid an impending deficit, the governor proposed \$380 million in budget cuts (about 3.7 percent of spending), together with use of most of the budget reserve. The governor also urged repeal of a 1985 law that would automatically suspend indexing of the personal income tax if the budget shortfall exceeds the amount set aside in the reserve fund.

Mississippi. The electorate may have an opportunity to vote on a new constitutional amendment submitted by the legislature that would ease property tax burdens on homeowners, while raising taxes on commercial property, motor vehicles, and utilities. Both legislative leaders and the governor have indicated that they want no increase in taxes. Budget cuts have been made because of revenue shortfalls (due in part to inaccurate estimates of the effects of certain tax increases approved last year). Because of commitments to spend more for education, the governor proposes 9 percent cuts in many state programs, along with diversion of some highway funds to general operation.

Missouri. Local groups are seeking a one-half of one

percent increase in the state sales tax (for \$150 million annually), coupled with state aid to cities to replace cutbacks in Federal grants. In response to Federal legislation in 1985, the legislature is considering a measure to exempt food-stamp purchases from sales tax; the estimated revenue loss to the state is \$12 million annually. Other issues result from the sizable shifts in property tax burdens caused by statewide assessments completed in 1985.

Nebraska. The state continues to face tight budget problems because of its sluggish economy. If tax receipts continue to lag behind projections, the legislature may consider one of several alternatives: first, raising the income tax from 19 percent of Federal tax liability to 20 percent; second, raising the sales tax from 3½ percent to 4 percent; or, third, levying a sales tax on services. A bill to authorize a statewide ticket lottery is said to be getting much attention.

New Hampshire. The governor proposed no tax increases and criticized "some individual legislators," who want to increase spending, of misunderstanding "the difference between needs and wants." He also asked the legislature to end the "snack tax," by exempting snacks such as candy bars from the 7.5 percent rooms and meals tax. The legislature is working on a proposal, strongly favored by the governor, to change the state's worldwide unitary tax on the income of multinational corporations to a "water's-edge" basis.

New Jersey. Noting that prior legislative action will save taxpayers about \$555 million in fiscal year 1987, the governor called for a 3 percent increase in state spending, the smallest rise in more than a decade.

New Mexico. The governor asked for an additional \$225 million in new revenues next year to improve education and serve other purposes. A compromise plan for education, worked out by the governor and legislative leaders, would raise state school spending by only about half of what the governor requested. The legislature approved a \$150 tax increase measure that would raise personal income and gross receipts taxes. Other bills before the legislature would raise cigarette taxes, increase motor fuels taxes, and impose a tax on tobacco products that are not now subject to tax.

New York. The governor's financial plan foresees a \$166 million excess of receipts over disbursements in fiscal 1987. Republican state senate leaders are calling for reductions in sales, personal income, and corporate income taxes totaling \$3.9 billion over five years. The governor is said to oppose further tax reductions; the legislature and the governor approved tax cuts last year totaling more than \$3 billion over a three-year period, mostly in personal income taxes.

North Carolina. At a budget session convening in June, the legislature may consider raising gasoline tax rates by 3 cents a gallon.

Ohio. The state's finances are reported to be "in good shape," after significant tax cuts in 1985. Several bills concerning local taxes are before the legislature, as well as a measure to impose an excise tax on tobacco products.

Oklahoma. Heavily dependent upon oil and gas activity,

the state's economy is weak, and state revenues from energy resources have fallen sharply. The governor's budget calls for spending 9 percent less in fiscal 1987 than in the current year; and additional spending cutbacks may be imposed.

Oregon. No legislative session is scheduled for 1986. A citizen's group is seeking an initiative that would cut property taxes and raise individual income taxes instead. The outlook for approval of the measure is uncertain, since four such initiatives have previously been turned down by the voters.

Pennsylvania. Following significant income tax reductions last year, the governor called for further cuts in both personal and business taxes. He proposed cutting the personal income tax rate from 2.2 percent to 2.1 percent (the lowest in eight years), reducing the corporate net income tax from 9.5 percent to 8.5 percent (the lowest in eighteen years, according to the governor), and cutting the capital stock and franchise tax. If approved, the annual reduction would be \$237 million; it would follow 1985 cutbacks in personal and corporate income taxes estimated at \$185 million a year. The governor also recommended that state spending growth be below the inflation rate.

Rhode Island. The governor advocated property tax relief for elderly homeowners. Bills in the legislature would lower the personal income tax and the state sales tax.

South Carolina. To avoid a \$46 million deficit in fiscal 1986, the state has cut most agency budgets by 2 percent. Legislation has been introduced to authorize local option taxes.

South Dakota. The legislature is considering increases in motor fuels and special fuels excise taxes from 13 cents to 14 cents a gallon, as well as a new tax on tobacco products.

Tennessee. The governor asked for a \$1.2 billion, ten-year, road-building program, to be financed by an increase in the gasoline tax from 12 cents to 15 cents a gallon. Because of the prospective ending of Federal general revenue sharing, the legislature may consider removing the cap on local sales taxes. The change would raise about \$120 million annually for localities. (Present law applies local sales tax only to the first \$1,100 of the purchase price of a single article of personal property.)

Texas. No regular session will be held in 1986. Concerns about state finances have heightened with the sharp decline in oil prices; the state is said to lose \$100 million in annual revenues for every \$1 a barrel drop in oil prices. In mid-February the state comptroller estimated a \$1.3 billion deficit for the biennium that began September 1, 1985. Shortly afterward, the governor issued an official executive order cutting spending by 13 percent for the two-year period. The size of the cut would vary by type of services, and exempt items would include local schools and highway construction and maintenance.

Utah. Adhering to his pledge when elected a year ago, the governor asked for no tax increases in 1986. He has indicated, however, that new revenue sources will be needed next year to support programs in education. A proposal in the

legislature would cut state-mandated property taxes for local school support and make up the shortfall by raising state taxes on individual and business incomes. An initiative petition to limit property taxes is circulating for the November 1986 ballot. The legislature approved a measure replacing the state's worldwide unitary approach for taxing corporate income to a "water's-edge" approach that allows taxation only of a firm's U.S. income. The bill's sponsors expressed hope that new business attracted to the state by the reform would make up for any revenue losses. (Last year, use of the "water's-edge" method was approved administratively.)

Vermont. The governor proposed modest state tax increases to finance a property tax homestead credit for homeowners with family incomes of \$32,000 or less. The credit would be financed by a new franchise tax on cable television, withdrawal of the income tax exemption on out-of-state tax-exempt bonds, and the elimination of loss carrybacks from personal and corporate income taxes.

Virginia. The legislature increased the gasoline tax 1.6 cents a gallon as part of a \$50 million highway improvement plan. The governor has said he will call a special legislative session in September to address highway finance issues, especially speeding up highway construction.

Washington. The governor's fiscal plan includes increases of 8 cents a pack on cigarettes and 16.75 percent on tobacco products, with proceeds earmarked for Puget Sound water pollution control. The budget adopted last year for the 1985-87 biennium will result in a \$136.8 million reserve, according to current forecasts. The governor has proposed additional supplemental expenditures.

West Virginia. The governor proposed no new taxes and presented the legislature with a budget that was in deficit by \$8.5 million. The constitution does not require the governor to submit a balanced budget, but it does require the legislature to enact one. The new state lottery is said to be a "wild card" and could produce a few million dollars over the estimate. The legislature may consider a casino gambling law, as well as raising the gasoline tax.

Wisconsin. In a special session of the legislature called by the governor in late January, the legislature adopted a \$340 million "budget repair" package, containing spending, revenue, and surplus adjustments, to bring the 1985-87 budget back into balance. The package is said to conform to the governor's stated principles for dealing with the budget gap—no increase in state taxes, no accounting gimmicks, an ending balance of at least \$75 million, spending cuts deep enough to ensure flexibility in shaping the budget for the next biennium, and budget adjustments which "spread the pain" evenly.

Wyoming. Although falling oil prices have sharply reduced the state's projected revenues (Wyoming gets nearly half its state tax revenue from the severance tax), no major fiscal problems are foreseen. The proposed spending budget has been cut, and the state has a \$100 million-plus "rainy day" reserve account.

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- During the years from 1954 through 1963, married couples with two dependents earning \$35,000 a year paid \$9,037 in Federal income taxes on average; by 1984, the tax was down to \$5,070; singles at the same income level with no dependents paid tax of \$13,778 in 1954-1963, compared to \$7,065 in 1984.

- Enrollment in public elementary and secondary schools peaked at just over 46 million pupils in school year 1971, after rising by some 20 million in the previous two decades; it is estimated at 39 million in 1986 and at 42 million in 1993.

- Federal, state and local expenditures in 1984 were equal to \$6,128 for every man, woman, and child in the nation. The Federal government spent 64 percent of the total.

- Gross debt of all U.S. governments amounted to \$8,779 per capita in 1984; over 75 percent of that was owed by the Federal government.

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THE FRONT BURNER

By Robert C. Brown, President
Tax Foundation, Incorporated

"Rustles of Springtime"

Spring is the season of hope. And hope has come to Washington. Of all places, hope has bloomed amid the thorns of the budget debate.

It must be official. *The New York Times* has reported that economists, the gloomiest of social scientists, have detected a falling trend in the Federal deficit. Not just government economists, mind you, who are paid to notice that sort of thing for whoever is in power at any given point in time; but private sector pundits who are presumably committed to a more objective reading of the fiscal tea leaves.

When the gloomy science starts smiling, we lesser mortals had better watch out. Things are seldom what they seem—especially in economics and even more especially in the economics of public finance.

There is a story about a group of travelers who fall into a pit. One is an engineer, one is a physicist, and one is an economist. The engineer says he can't do anything to extricate the trio, because there are no structural materials to build scaffolding. The physicist says he can't help out his comrades, because there is no energy source available to use to transform matter into motion.

The economist reassures them. He has the solution. "Assume we have a ladder. . . ." he says.

The optimists in the ranks of economic forecasters may be assuming we have a ladder, I'm afraid. At best, we have solved a hypothetical deficit with hypothetical deficit reduction measures.

No one knows if Gramm-Rudman-Hollings will be found unconstitutional, much less if Congress will choose to follow its stringent disciplines. Congress certainly managed to ignore the Byrd amendment, passed in 1978, which flat-out obliged the House and the Senate to pass a budget that was in balance, beginning in FY 1981.

Also, the free fall in the dollar may accelerate, causing a financial crisis that will worsen the deficit situation. Interest rates may stop falling; unemployment may rise; the farm credit system could collapse; any number of budget busting developments could occur.

So, at the risk of sounding dismal, we feel a note of caution must be raised. Perhaps the winter of our fiscal discontent is indeed ending. But one budgetary swallow, does not constitute a deficit reduction spring.

Stay on guard!

"BUT WHAT IF THEY DON'T COME UP?"



TAX FOUNDATION, INCORPORATED

(FEDERAL TAX BILL, from page 1)

the lion's share—\$2,354 from annual earnings for this \$28,000-a-year family. Social security taxes funnel another \$2,002 to Washington.

However, direct levies account for only about three-fifths of the Federal tax take, according to Tax Foundation analysts. To these must be added such indirect taxes as employer's share of social security taxes; corporate income taxes; excise taxes on such items as gasoline, liquor and tobacco; and miscellaneous levies. These will take another \$2,511 from the moderate earner's paycheck.

Altogether, direct and indirect Federal taxes claim almost 25 percent of this family's annual income. But even that does not tell the whole story.

After paying a big slice of current earnings for taxes, the family must assume its \$1,848 share of the \$202.8 billion fiscal 1986 deficit. All told, current Federal taxes and borrowing add up to \$8,715, or 31 percent of this moderate-income family's earnings.

(SHADOW BUDGET COMMITTEE, from page 1)

He is a Director of The Interpublic Group of Companies; Trustee, Atlantic Mutual Insurance Company; Director, Centennial Insurance Company; and a member of the Advisory Council of the Tax Foundation and of the Panel of Economic Advisers to the Congressional Budget Office.

The Honorable Harry F. Byrd, Jr., represented Virginia in the United States Senate from 1965 to 1982. During his Senate career, he served on the Committee on Finance (1969-1982), Senate Armed Services Committee, and Joint Committee on Taxation. Senator Byrd is also a Trustee of the Tax Foundation.

W. Bowman Cutter, a Partner in the accounting firm of Coopers and Lybrand, was Executive Associate Director for Budget, Office of Management and Budget, from 1977 to 1981.

Allen Schick is Professor, School of Public Affairs, The University of Maryland. He was previously Senior Specialist, Congressional Research Service.

Single copies of the 18-page report, "Achievability of Fiscal 1987 Budget Targets," are available from the Tax Foundation Public Information Department at no charge.

How the Federal Government Will Spend A Worker's Tax Dollars in Fiscal 1986^a

Function	Worker's share		Total spending (millions)
	Amount	Percent of total	
Income security ^b	\$2,150	31.32	\$318,146
National defense	1,797	26.17	265,827
Net interest	965	14.05	142,740
Health ^c	705	10.27	104,330
Education, training, employment, and social services	207	3.02	30,671
Transportation	183	2.67	27,106
Veterans' benefits and services	180	2.62	26,619
Agriculture	175	2.55	25,871
International affairs	116	1.69	17,141
Natural resources and environment	87	1.27	12,905
General science, space, and technology	60	.87	8,899
Community and regional development	54	.78	7,922
Administration of justice	46	.67	6,788
General government	42	.62	6,270
General purpose fiscal assistance	42	.61	6,236
Energy	30	.44	4,433
Commerce and housing credit	26	.37	3,802
Total ^d	\$6,867	100.00	\$979,928
Exhibit:			
Payments for individuals	\$3,124	45.5	\$445,861

^a In this example, the worker is the sole source of support for a spouse and two dependent children, and earns \$28,000 per year.

^b Includes social security, Federal employee retirement, unemployment compensation, housing assistance, food and nutrition assistance; excludes veterans' income security.

^c Includes medicare, medicaid, and others; excludes veterans' hospital and medical care.

^d After deducting \$35,776 million in undistributed offsetting receipts not classified by function.

Source: Tax Foundation computations, based on Federal Budget presented February 5, 1986 (Office of Management and Budget) and tax laws from Treasury Department.

(STATE TAX RATES, from page 2)

Individual Rates

Minnesota (14 percent); New York (13.5 percent); Connecticut (on a limited base), Iowa, and West Virginia (13 percent) had the highest marginal individual income tax rates. The rate schedules are progressive (i.e., rise as income brackets go up) in all but five states. Illinois, Indiana, Massachusetts, Michigan, and Pennsylvania apply a flat rate, regardless of income level. In three states, income taxes are levied as a percentage of Federal individual income tax obligations—Nebraska, Rhode Island, and Vermont.

The maximum corporate income tax rates are highest in Iowa and Minnesota (12 percent); Connecticut (11.5 percent); Arizona and North Dakota (10.5 percent); and New York (10 percent).

Gasoline Tax

Gasoline taxes were highest in Washington (18 cents); Nebraska (17.2 cents); Minnesota (17 cents); Arizona, Louisiana, and Wisconsin (16 cents); Connecticut, Michigan, and Montana (15 cents); and Hawaii (where combined state-local rates range from 15 to 18.5 cents per gallon). Florida (4 cents); Missouri (7 cents); Alaska, New Jersey, New York, and Wyoming (8 cents) place the lowest levies on gasoline. The motor fuels taxes in Georgia, Kentucky, Maryland, and Rhode Island are levied

at specific percentages of the wholesale or retail selling price of the product. In addition, some states also tax motor fuels under the states' general sales tax.

Cigarette Tax

Cigarette taxes also make a notable contribution to state tax revenues, Tax Foundation economists report. In fiscal 1984, the states collected \$4.1 billion, 2.1 percent of their total taxes, from tobacco products excises.

The table on page 2 gives further details, as of January 1, 1986, for major taxes and rates prevailing in the states.

Erratum

Page one of the January 1986 *Federal Tax Policy Memo* (entitled "The House Tax Bill") contained a discussion of the marginal rate structure under HR 3838. It was stated erroneously that married taxpayers with \$43,000-\$49,000 in taxable income would face a two point increase in their marginal rate from 33% to 35%. This did not take into account the changed definition of taxable income that would result from the proposed switch back to the standard deduction and taking the zero bracket amount out of the rate tables. There still would be such a marginal notch problem, but it would affect a smaller group—more precisely, in the case of joint returns, those with \$46,700—\$49,400 in taxable income at 1986 levels.